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Early Tax Reform Details Provide Good, Bad, In-Between News for Tax Credits

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When specific details finally emerged about tax reform legislation promised for months by Republican leadership in Congress and the White House, it was a good news, bad news, in-between news story.

The good news: the GOP's unified framework explicitly included the low-income housing tax credit (LIHTC), one of two business tax incentives provisions that would remain (along with the research and development credit).

The bad news: The federal new markets tax credit (NMTC), historic tax credit (HTC), as well as the renewable energy investment tax credit (ITC) and production tax credit (PTC) were left out.

The bad news isn't necessarily all bad. Exclusion isn't final, because the framework included a phrase that attracted the attention of all tax credit advocates: "the [tax-writing] committees may decide to retain some other business credits to the extent that budgetary limitations allow."

The other credits aren't dead. They're in limbo.

The "budgetary limitations allow" phrase created the possibility of not only saving the credits–particularly the NMTC and HTC–but improving them. After all, comprehensive tax reform (if it occurs) will be just that: an opportunity to rewrite the tax code. If tax credit advocates successfully argue that the HTC and NMTC fit within budgetary limitations, there is an opportunity to improve and strengthen them.

Here's a look at what the tax-writing committees–and ultimately the House and Senate–will consider concerning the LIHTC, NMTC, HTC and RETCs.

(Mostly) Good News for LIHTC

The explicit inclusion of the LIHTC in the unified framework (which checked in at about 1,500 words, about the length of this column. It was a framework, light on details) was good news. The LIHTC will likely stay.

That is an affirmation for the credit–which has been called the most successful private-public partnership in America for nearly 30 years–and its advocates. Tax credit advocates kept success stories in front of Congress.

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The widespread support of the Affordable Housing Credit Improvement Act of 2017 (which has 21 co-sponsors in the Senate including Sen. Maria Cantwell, D-Wash., is evidence of the legislative approval of the credit. That legislation would not only retain the LIHTC, but increase the allocation of 50 percent over a five-year phase in and make several other significant improvements. A similar bill in the House–albeit without the 50 percent increase–has 104 co-sponsors, including Rep. Pat Tiberi, R-Ohio.

However, while the LIHTC was retained in the GOP framework, there were some dark clouds–including that the status of private activity bonds (PABs) in tax reform is uncertain. PABs finance about half of all LIHTC homes, so their absence in a new tax framework would be devastating.

Another concern is a suggested provision that would switch the current consumer price index (CPI) factor with a "chained CPI." That's important, because the chained CPI is lower, which would reduce future LIHTC and private activity bond allocations. This provision was likely included to help offset the cost of tax reform after the first 10 years and help ensure tax reform complies with budget reconciliation rules.

Another concern is that the proposed 20 percent top corporate tax rate (down from the current 35 percent) might decrease investor appetite for the LIHTC and further reduce equity pricing for credits–a reaction that started with just the threat of tax reform.

There are other potential outcomes of tax reform for the LIHTC, including making changes in the program, such as making the credit period 15 years, rather than 10, to match it with the compliance period. That again could make the credit less attractive to investors.

Of course, there's one final concern: the fact that the LIHTC could still be removed during the legislative process.

Some good news, though: those who worry about the effect of a lower corporate rate on the LIHTC need to remember that there will still be plenty of corporate tax liability, even at a 20 percent rate. According to the Congressional Budget Office (CBO), corporations are currently projected to pay $3.9 trillion in taxes over the next 10 years. Even if tax reform is enacted with roughly half of the proposed $1.5 trillion of tax cuts going to corporations, that still leaves about $3.2 trillion in projected corporate tax liabilities. And if other tax credits are eliminated, the LIHTC becomes an even more attractive option for investors, regardless of the corporate rate.

Bad (but Possibly Good) News for NMTC, HTC

While the HTC and NMTC were left out of the framework, the caveat ("the committees may decide to retain some other business credits to the extent that budgetary limitations allow") works in their favor.

The HTC, for instance, has a microscopic impact on the federal budget and creates plenty of economic bang for its buck.

An estimated $700 million in HTCs were claimed out of a total of about $131 billion in federal corporate tax expenditures in 2015, according to a report of the Joint Committee on Taxation. That's barely half of 1 percent of the total. HTC proponents will highlight not only that, but the fact that in 2015 alone (the last year for which statistics are available), HTC-related investments created about 86,000 jobs and were responsible for $4.8 billion in gross domestic product.

The case can be made that the HTC is well worth fitting in the "budgetary limitations." Plus, it has powerful

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advocates. The Historic Tax Credit Improvement Act of 2017 has 13 cosponsors in the Senate and 75 cosponsors in the House.

The NMTC, likewise, can make the case for remaining in the tax code beyond its scheduled expiration after 2019.

The credit currently "costs" the government $1.2 billion per year, according to the JCT report, which is 0.9 percent of the total corporate tax expenditures. Remember: individual expenditures (deductions, etc.) make up 90 percent of the expenditures in the tax code.

The New Markets Tax Credit Coalition's Progress Report this year showed that the NMTC created 36,000 jobs in 2016 and that community development entities used $1.8 billion in allocations to finance projects totaling $4 billion in costs.

Like the HTC, proponents of the NMTC can make the case that the tax credit is not only worth retaining due to it fits under "budgetary limitations," it has significant support in Congress. Twelve Senators and 76 members of the House cosponsored the New Markets Tax Credit Extension Act of 2017.

The opportunity is there for NMTC supporters to retain the credit and perhaps get the provision of the New Markets Tax Credit Extension Act allowing it to be taken against the alternative minimum tax (if retained) included in tax reform. The NMTC community has a chance to have the credit retained and made permanent. But it's a battle and we can't take it for granted that Congress will retain the NMTC and HTC absent advocacy from the community development and historic preservation stakeholders.

Bad News for RETCs

While the HTC and NMTC were left out and supporters rallied, the news was a little dimmer for those in the renewable energy tax credit world. Part of that is because many RETC supporters have already made peace with the possibility that the phase-down provisions made by the PATH Act of 2015.

The ITC is scheduled to gradually drop from 30 percent to 10 percent by 2022, while the PTC is scheduled to drop 20 percent per year until 2020, when it goes away. Tax reform, if passed, isn't the death knell of the RETCs, but compared to the LIHTC, NMTC and HTC, they face a significantly tougher road to be extended beyond the PATH Act provisions.

Bad News/Good News for State Credits

While state tax credits (by our recent count, 32 states have state-level HTCs, 15 have state-level LIHTCs and 14 have state-level NMTCs) are statutorily unaffected by their federal tax law changes, any significant change in the federal laws will impact the states.

And it's not all bad.

The negative side is that many state credits are linked to federal credits. Some actually require the allocation of federal credits to get the state credit, but more are used in conjunction with the federal credit to make transactions (particularly HTCs) pencil out. So the loss of the federal NMTC or HTC would harm most state credits.

But there's a bright side, too.

If, as the GOP framework suggests, the new tax code eliminates the deduction for state and local income taxes (the framework calls for the elimination of "most itemized deductions" and only mentions retaining home mortgage interest and charitable contributions

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incentives), there will likely be a significant jump in people looking for ways to reduce their state income tax. The result could be more activity by high-earning individuals in state tax credit markets, albeit changes in state tax law may be needed to open up some state tax credit programs to individual investors. The repeal of the state and local tax deduction would also increase the value of state tax credits to individual investors, which should translate into an increase in pricing for state tax credits.

There's still a long way to go. Both houses of Congress need to agree on a budget (which hadn't happened yet as we went to press) and then go through the process of writing the legislation. The House and Senate must approve the final bill. All along the way, tax credit advocates will have the opportunity to lobby legislators to retain, enhance and make permanent (in the NMTC's case) their credits.

There's good news, bad news and in-between news. It may take a while before we know the final answer for the tax credit community. ❖

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